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CERTIFIED FOR PUBLICATION

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FIRST APPELLATE DISTRICT

DIVISION ONE

WILLIAM HAMILTON, et al., Plaintiffs and Respondents, v. MARYLAND CASUALTY COMPANY, et al., Defendant and Appellant.	A085219 (Contra Costa County Super. Ct. No. C 94-05338)

This case presents issues concerning the rights of claimants against an insurer after the insured, without the approval of the insurer, entered into a good faith settlement agreement with the claimants that included an assignment to the claimants of any contract rights the insured had against the insurer. We find that such a settlement agreement is not binding on an insurer that was actively involved in defending its insured and did not agree to the settlement. We further find that under the "no action" provisions in the insurance policy, the claimants may not bring a direct action on the policy against the insurer until they have obtained a judgment against the insured after an actual trial or until the insurer has agreed to a settlement. Finally, although we find that the "no action" provisions of the policy do not preclude an action against the insurer for breach of the covenant of good faith and fair dealing in failing to enter into a reasonable settlement agreement, such an action may not be brought against an actively defending insurer until the claimants have obtained a judgment against the insured in excess of policy limits.

BACKGROUND

Victoria Lee Parker and VLP Enterprises (VLP) owned and operated a San Diego franchise of Great Expectations Creative Management, (Great Expectations), a dating

service. Maryland Casualty Company (Maryland) issued to VLP two successive commercial insurance policies, each with a $1 million policy limit.

In March 1990, William Hamilton, Paula Arnett, Susan Choate, Thomas Fort and Yvonne Kaut, et al., (the claimants), clients of various Great Expectations franchises, filed a complaint in the Contra Costa superior court, naming as defendants Great Expectations, each of its franchises and the owners of each franchise. The claimants alleged that the defendants had invaded the privacy of their clients and prospective clients, and had violated Penal Code sections 631, subdivision (a), and 632, subdivision (a),[1] in that the defendants secretly had recorded, amplified and broadcasted the

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[1] Penal Code section 631, subdivision (a) provides:
"(a) Any person who, by means of any machine, instrument, or contrivance, or in any other manner, intentionally taps, or makes any unauthorized connection, whether physically, electrically, acoustically, inductively, or otherwise, with any telegraph or telephone wire, line, cable, or instrument, including the wire, line, cable, or instrument of any internal telephonic communication system, or who willfully and without the consent of all parties to the communication, or in any unauthorized manner, reads, or attempts to read, or to learn the contents or meaning of any message, report, or communication while the same is in transit or passing over any wire, line, or cable, or is being sent from, or received at any place within this state; or who uses, or attempts to use, in any manner, or for any purpose, or to communicate in any way, any information so obtained, or who aids, agrees with, employs, or conspires with any person or persons to unlawfully do, or permit, or cause to be done any of the acts or things mentioned above in this section, is punishable by a fine not exceeding two thousand five hundred dollars ($2,500), or by imprisonment in the county jail not exceeding one year, or by imprisonment in the state prison, or by both a fine and imprisonment in the county jail or in the state prison. If the person has previously been convicted of a violation of this section or Section 632, 632.5, 632.6, 632.7, or 636, he or she is punishable by a fine not exceeding ten thousand dollars ($10,000), or by imprisonment in the county jail not exceeding one year, or by imprisonment in the state prison, or by both a fine and imprisonment in the county jail or in the state prison."
Penal Code section 632, subdivision (a) provides:
"(a) Every person who, intentionally and without the consent of all parties to a confidential communication, by means of any electronic amplifying or recording device, eavesdrops upon or records the confidential communication, whether the communication is carried on among the parties in the presence of one another or by means of a telegraph, telephone, or other device, except a radio, shall be punished by a fine not exceeding two thousand five hundred dollars ($2,500), or imprisonment in the county jail not exceeding

confidential conversations of their clients and prospective clients. The complaint stated a proposed class made up of all persons who had been interviewed at any of Great Expectations' franchises.

Maryland undertook VLP's defense. In June 1991, John Bates, a special master appointed by the court, stayed all discovery and motions in the proceedings.

On June 15, 1993, the claimants offered to settle with VLP for either $1 million or possibly, $500,000.[2] Maryland, in accordance with the language of its policies, declined to accept that offer, countering with its own offer to settle for $150,000. After these negotiations produced no settlement, VLP itself entered into a September 1993, settlement agreement with the claimants as a part of a global settlement between the claimants and all defendants. Under the terms of the global settlement, the defendants agreed to discontinue any further electronic eavesdropping on prospective clients and to provide certain benefits to existing clients. As relevant here, VLP further agreed to have a stipulated judgment entered against it in the amount of $3 million, and to assign to the claimants any contractual right it might have against Maryland, in return for which the claimants agreed not to execute the judgment against VLP. Maryland took no part in the settlement negotiations and, when presented with the agreement, neither approved nor opposed the settlement.

The special master recommended to the superior court that it approve the settlement, reporting his belief that it was reasonable, proper, and in the best interests of the class. The superior court thereafter provisionally certified a plaintiffs' class, for purposes of settlement only, comprised of all individuals who had participated in a preliminary membership interview at one of the franchises. It then confirmed the settlement as a good faith settlement, pursuant to Code of Civil Procedure section 877.6,

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one year, or in the state prison, or by both that fine and imprisonment. If the person has previously been convicted of a violation of this section or Section 631, 632.5, 632.6, 632.7, or 636, the person shall be punished by a fine not exceeding ten thousand dollars ($10,000), by imprisonment in the county jail not exceeding one year, or in the state prison, or by both that fine and imprisonment."

declaring it to be "fair, reasonable, non-collusive and in good faith," and entered judgment in favor of the claimants and against VLP.

In December 1994, the claimants, as VLP's assignees, instituted the present action against Maryland, seeking damages for breach of the insurance contract on the theory that VLP was entitled to contractual damages from Maryland for Maryland's failure to accept the claimants' settlement offers, and further alleging that Maryland was estopped from challenging the reasonableness of the settlement.[3] Maryland moved for summary judgment, arguing that because it at all times was defending the action brought by the claimants against its insured, there was no breach of the insurance contract and thus no contractual claim against it that could be assigned under the terms of the settlement agreement. Maryland further argued that because it continued to defend its insured, it was neither bound by the settlement agreement, nor estopped from challenging the reasonableness of the settlement. The superior court rejected Maryland's arguments, and denied its motion for summary judgment.

The claimants then filed a motion for summary judgment against Maryland, arguing that the fact of the ultimate settlement, and the circumstances surrounding that settlement, established that Maryland had breached the covenant of good faith and fair dealing by failing to accept the claimants' offers to settle their claims against VLP for $1 million and/or $500,000. The trial court agreed with this argument. It further found that there was no factual dispute either as to Maryland's breach of the covenant of good faith and fair dealing or as to the damages resulting from that breach, and entered judgment in favor of the claimants for $3 million, plus prejudgment interest.

This appeal followed.

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[2] There is a dispute as to whether the claimants actually offered to settle for $500,000.

DISCUSSION

I.

Direct Action

Insurance Code section 11580 requires insurance policies to contain certain provisions, including, as relevant here, "A provision that whenever judgment is secured against the insured in an action based upon bodily injury, death, or property damage, then an action may be brought against the insurer on the policy and subject to its terms and limitations, by such judgment creditor to recover on the judgment." As required by section 11580, Maryland's insurance policies recognize the right of a third party to bring an action directly against Maryland. The policies, however, limit this right, providing, as relevant here, "No person or organization has a right under this Coverage Part . . . [t]o sue us on this Coverage Part unless all of its terms have been fully complied with. [¶] A person or organization may sue us to recover on an agreed settlement or a final judgment against an insured obtained after an actual trial; but we will not be liable for damages that are not payable under the terms of this Coverage Part that are in excess of the applicable limit of insurance. An agreed settlement means a settlement and release of liability signed by us, the insured and the claimant or the claimant's legal representative."

The Fifth Division of this court recently explained that a limitation such as that in Maryland's policies (sometimes called a "no action" clause[4]), "gives the insurer the right

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[3] VLP expressly did not assign to the claimants any tort claims it might have against Maryland.

[4] The claimants correctly point out that Maryland's policy language differs from that of the usual "no action" clause in that it permits a third party to sue when certain conditions have been met, whereas the usual "no action" clause prohibits a third party suit unless certain conditions have been met. The distinction might be significant if Insurance Code section 11580 conferred an absolute right on third parties to bring a direct action against a tortfeasor's insurance company. Section 11580, however, provides only that an insurance policy must contain language permitting such suits. Maryland's policy contains such language, but in conferring the right to sue, limits it. The third party's right to sue therefore, extends only as limited by Maryland's policy language. For purposes of the claimants' arguments here, the effect of Maryland's policy language, accordingly, does not differ from the effect of the more standard "no action" provisions.

to control the defense of the claim—to decide whether to settle or to adjudicate the claim on its merits. [Citation.] When the insurer provides a defense to its insured, the insured has no right to interfere with the insurer's control of the defense, and a stipulated judgment between the insured and the injured claimant, without the consent of the insurer, is ineffective to impose liability upon the insurer." (*Safeco Ins. Co.* v. *Superior Court* (1999) 71 Cal.App.4th 782, 787.)[5]

It is true that when the insurer does *not* provide a defense, or denies coverage, the insured is entitled to make a reasonable settlement of the claim in good faith and may then maintain an action against the insurer to recover the amount of the settlement. (*Isaacson* v. *California Ins. Guarantee Assn.* (1988) 44 Cal.3d 775, 791; *Safeco Ins. Co.* v. *Superior Court*, *supra*, 71 Cal.App.4th at p. 787; *Clark* v. *Bellafonte Ins. Co.* (1980) 113 Cal.App.3d 326, 335-336.) *Pruyn* v. *Agricultural Ins. Co.* (1995) 36 Cal.App.4th 500, cited extensively by the claimants, was such a case. The principles recognized by the courts in cases such as *Pruyn*, however, have no application here, where Maryland *did not* deny coverage and *did* provide a defense. As the court in *Pruyn* stated, "Of course, where the insurer has fulfilled its contractual obligation to provide a defense to the underlying action, a settlement of that action by the insured without the consent of the insurer will have entirely different consequences. First, such a settlement would probably breach the policy's 'cooperation' clause and give the insurer a defense to an action on the policy if prejudice could be shown. [Citation.] Second, the standard 'no action' clause, such as exists in the policy before us, . . . will preclude any recovery by the insured of amounts which may have been paid to the claimants. [Citation.] As one court put it, '. . . where an insurer provided a defense to its insured in the underlying litigation, and the insured, without the participation or the consent of the insurer, stipulated to a judgment without evidentiary support and with no potential for personal loss, such judgment is insufficient to impose liability on the insurer in a later action against the insurer under

[5] The policy language confers on Maryland the discretion to settle any claim or suit brought against its insured.

section 11580. To hold otherwise would create in the insured the ability to escape all liability for his or her own wrongdoing while imposing on the insurer totally unsupported liability. The potential for fraud and collusion is evident.' [Citation.]" (*Pruyn* v. *Agricultural Ins. Co., supra,* 36 Cal.App.4th at pp. 515-516, citing *Wright* v. *Fireman's Fund Ins. Companies* (1992) 11 Cal.App.4th 998, 1024.)

There is some authority for the proposition that where there is evidentiary support for a judgment, such a judgment may satisfy the "judgment after actual trial" provision of a no action clause. The court in *National Union Fire Ins. Co.* v. *Lynette C.* (1994) 27 Cal.App.4th 1434, after surveying the existing case law, found that a trial need not be adversarial to be considered an "actual trial" against an insurer. Rather, "[i]n deciding whether a judgment involving the injured party and the insured is binding on the insurer, courts focus on whether the facts have been adjudicated independently in a process that does not create the potential for abuse, fraud or collusion. This concern is heightened when the injured party provides the insured with a covenant not to execute. From this distillation, we conclude that the term 'actual trial' in the standard 'no action' clause has two components: (1) an independent adjudication of facts based on an evidentiary showing; and (2) a process that does not create the potential for abuse, fraud or collusion." (*Id.* at p. 1449.)

The claimants contend that principles recognized in *National* should apply here because the judgment was entered only after extensive negotiations overseen by the special master, was reviewed by both the special master and the superior court, and was adjudicated to be a good faith settlement under Code of Civil Procedure section 877.6. We disagree. In deciding that a particular settlement was made in good faith, the court adjudicates the good faith of the settling tortfeasor as against the interests of non-settling tortfeasors, but not the good faith of the settling tortfeasor as against the interests of its insurer. The court's primary concern is whether, assuming liability, the settling tortfeasor is paying *less* than its proportionate share of the plaintiff's loss, and the evidence submitted by the parties is relevant to that question. Similarly where, as here, the action is a purported class action, the reviewing court has little reason to be concerned with

whether a particular defendant is agreeing to pay too much. The court's concerns, rather, are with the fairness of the settlement vis a`vis named and unnamed members of the class.

The concerns of the settling tortfeasor's insurance company, however, are quite different. The insurer is concerned with whether its insured too easily is admitting liability, or is agreeing to pay *more* than its proportionate share of the plaintiff's loss. The section 877.6 hearing is not designed to test those questions. It follows that for purposes of a dispute between the settling tortfeasor and its insurance company, the evidentiary showing made at the section 877.6 proceedings cannot be a substitute for an actual trial. It also follows that as to the paying insurance company, section 877.6 proceedings afford little protection from the possibility of abuse, fraud or collusion, especially where, as here, the settlement includes a covenant not to execute against the settling tortfeasor. "With no personal exposure the insured has no incentive to contest liability or damages. To the contrary, the insureds' best interests are served by agreeing to damages in any amount as long as the agreement requires the insured will not be personally responsible for those damages." (*Wright* v. *Fireman's Fund Ins. Companies*, *supra*, 11 Cal.App.4th at p. 1023; and see also, *Pruyn* v. *Agricultural Ins. Co.*, *supra*, 36 Cal.App.4th at pp. 523-527.)

We recognize, of course, that the participation of the special master in the proceedings reduced the potential for abuse, fraud or collusion, and may indicate the existence of evidentiary support for the settlement. Again, however, the special master's interest in the matter was not co-extensive with Maryland's interests. Moreover, the record discloses that the claimants may have been willing to settle their claims against VLP for $500,000 and that the special master suggested to counsel for VLP that a $400,000 to $500,000 contribution by Maryland would be appropriate. That evidence, alone, indicates that the $3 million settlement amount, although reasonable and fair as to the claimants and other defendants, may not have been reasonable and fair as to Maryland. In addition, Maryland's liability, if any, would depend in part on whether the matter was tried as a class action, and although the matter was certified as a class action,

that certification was made for purposes of settlement only. Finally, the early stay of discovery necessarily reduced the evidentiary support for—and possibly against—the settlement. What may have appeared to be a reasonable settlement in light of the available evidence might well have appeared to be unreasonable had the evidence been more fully developed.

The rationale behind binding an insurer to a judgment reached after something less than a full adversarial trial, also is missing here. Thus, it has been recognized that a sound reason exists for binding a non-participating insurer to a final judgment entered after significant adjudicatory action by the trial court, when the insurer's lack of participation is a result of its abandonment of its insured. "The insurer not only had a right to participate in and to control the litigation, it had a duty to do so. An insurer which has wrongfully abandoned its insured should not be heard to complain or [be] allowed to relitigate the trial court's judgment merely because the default or uncontested proceedings followed, and were related to, an agreement between the insured and the claimant. Whatever the terms of the settlement, the entry of judgment was based on an independent review and adjudication of the evidence by the trial court. An insurer which has breached its contract is properly bound by the result of such trial proceedings and will not be heard to raise the policy's 'no action' clause in defense." (*Pruyn* v. *Agricultural Ins. Co., supra,* 36 Cal.App.4th at p. 517.) This rationale cannot and does not apply here where Maryland never abandoned VLP, and was actively continuing to defend its insured at the time the insured entered into the settlement agreement.

In short, we conclude that the proceedings occurring here, notwithstanding the participation and recommendations of the special master, and the finding of good faith and lack of collusion by the superior court, were not the equivalent of an "actual trial" for purposes of permitting the claimants to maintain a direct action against Maryland. It follows that the settlement and judgment were in no way binding on Maryland. Moreover, the claimants have cited no authority for their claim that an actively defending insurer should be estopped from challenging the reasonableness of a settlement entered into by its insured without its consent. Indeed, the authorities cited above support a

contrary position, because once it is determined that such a settlement has no binding effect on the actively defending insurer, there is nothing for the insurer to challenge.

II.

Breach of the Covenant of Good Faith and Fair Dealing

As discussed above, the claimants had no right to bring a direct action against Maryland. The claimants, however, also are assignees of VLP's contract claims against Maryland, and therefore assert the right to bring against Maryland an action for breach of the covenant of good faith and fair dealing inherent in its contract with VLP.[6] It also is true that the covenant of good faith and fair dealing may be breached by the failure of an insurer to accept a reasonable settlement offer on a covered claim. (*Isaacson* v. *California Ins. Guarantee Assn., supra,* 44 Cal.3d at pp. 792-793.) An action for breach of the covenant of good faith and fair dealing, however, cannot be instituted until a judgment has been entered against the insured that exceeds the insurer's policy limits. (*Communale* v. *Traders & General Ins. Co.* (1958) 50 Cal.2d 654, 660-661; *J.B. Aguerre, Inc.* v. *American Guarantee & Liability Ins. Co.* (1997) 59 Cal.App.4th 6, 13; *Doser* v. *Middlesex Mutual Ins. Co.* (1980) 101 Cal.App.3d 883, 891-892; *Critz* v. *Farmers Ins. Group* (1964) 230 Cal.App.2d 788, 799, disapproved on other grounds in *Crisci* v. *Security Ins. Co.* (1967) 66 Cal.2d 425, 433.) "As long as the insurer is providing a defense, the insurer is allowed to proceed through trial to judgment. The assignment of the bad faith cause of action becomes operative after the excess judgment

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6 Maryland takes the position that because VLP's assignment of claims to the claimants was an assignment of contract claims, the action instituted against it by the claimants must be deemed an action on the contract under Insurance Code section 11580 and thus an action barred by the "no action" provisions of Maryland's policies. The present suit, however, is not an action on the policies, attempting to recover benefits due under them, but an action for *breach* of the policies, attempting to recover damages resulting from the alleged breach. Such an action is not addressed by Insurance Code section 11580 nor is it barred by the policies' "no action" provisions. (*Camelot by the Bay Condominium Owners' Assn.* v. *Scottsdale Ins. Co.* (1994) 27 Cal.App.4th 33, 43, fn. 4.)

has been rendered." (*Safeco Ins. Co.* v. *Superior Court, supra,* 71 Cal.App.4th at pp. 788-789.)[7]

This rule, of course, would not apply if the insurer itself has elected not to proceed through trial to judgment. Thus, again, if the insurer denies coverage, or refuses to defend, its insured may enter into a settlement agreement with the claimants, and thereafter maintain an action against the insurer to recover the amount of the settlement. (*Isaacson* v. *California Ins. Guarantee Assn., supra,* 44 Cal.3d at p. 791; *Clark* v. *Bellafonte Ins. Co., supra,* 113 Cal.App.3d at pp. 335-336.) In addition, an insurer that has itself entered into a settlement agreement cannot avoid a suit for breach of the covenant of good faith and fair dealing on the grounds that the matter did not proceed to trial and judgment. In *Isaacson* v. *California Ins. Guarantee Assn., supra,* 44 Cal.3d 775, for example, the insurer agreed to pay a portion of a settlement offer. Rather than proceed to trial, the insureds paid the remaining portion themselves. In a later action for reimbursement brought by the insureds against their insurer, the Supreme Court held that the insureds were entitled to judgment against the insurer if they could prove that the insurer in fact acted unreasonably in failing to accept a settlement offer on a covered claim. (*Id.* at pp. 793-794.) The procedure recognized by the court in *Isaacson*, however, is limited to facts such as those present there, where the insurer participated in the settlement agreement, and with that participation completed its defense of the claim. Under those circumstances, the damages of the insured, if any, were fixed by the settlement, and the reasonableness of the insurer's actions must be determined in light of the information available as of the time of the settlement. Where, as here, the insurer does not participate in the settlement agreement and continues to provide a defense to its

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[7] Indeed, this division found in *Smith* v. *State Farm Mut. Auto. Ins. Co.* (1992) 5 Cal.App.4th 1104, 1113-1114 that ordinarily, a judgment against the insured is a condition to the insured's right to assign to the claimant a cause of action for bad faith against the insurer. (Cf. *Pruyn* v. *Agricultural Ins. Co., supra,* 36 Cal.App.4th at pp. 520-522; *McLaughlin* v. *National Union Fire Ins. Co.* (1994) 23 Cal.App.4th 1132, 1153-1154.)

insured, it cannot be determined if the failure to settle will cause actual injury to the insured until the defense has been completed and actual damage to the insured has been ascertained.[8]

It follows that the trial court erred in granting summary judgment to the claimants, and essentially binding Maryland to a settlement agreement and judgment to which it did not stipulate. In addition, it follows that the claimants' complaint was prematurely filed. Until a judgment in excess of Maryland's policy has been entered against VLP, or VLP otherwise has suffered some actual injury as a result of the alleged breach of the covenant of good faith and fair dealing, it has no claim to assign.[9]

The claimants contend that a conclusion such as that reached here is inconsistent with the policy against exposing insureds to unreasonable risks. The insured, of course, always will be interested in obtaining a settlement within policy limits. That interest, however, does not and cannot so override the interest of the insurer as to compel the insurer to accept any and all settlement agreements, whatever their merit, so long as they do not exceed policy limits. In addition, the risks to an insured such as VLP are limited in at least some degree by the fact that an insurer that has failed to enter into a reasonable settlement within the policy limits ordinarily will be liable for any excess judgment. (*Communale* v. *Traders & General Ins. Co., supra,* 50 Cal.2d 654, 660.) The insured, therefore, and the claimants, will have recourse to the insurer's assets should the action result in a judgment in excess of the policy limits. We also do not view our conclusion as unduly discouraging the settlement of claims. To be sure, it may discourage a claimant

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8 There is authority for the proposition that unreasonable settlement conduct may give rise to a claim against the insurance company on some basis other than exposing the insured to excess liability. (See *J.B. Aguerre, Inc.* v. *American Guarantee & Liability Ins. Co., supra,* 59 Cal.App.4th at pp. 13-15.) The complaint filed by the claimants, however, states no facts to support such a claim.

9 We note that the settling parties recognized this possibility by providing that should it be determined that the stipulated settlement was not binding on a non-participating insurer such as Maryland, the claimants reserved the right to establish VLP's liability and their damages in a separate proceeding in which the non-participating insurer would be provided with the opportunity to defend their claims.

and an insured from entering into a settlement such as occurred here, but the insurer still will be interested in settling the matter so as to reduce its exposure. Similarly, a claimant still will be interested in settling the matter so as to avoid the costs and burden of litigation and the possibility of a defense verdict.

CONCLUSION

For all of the above reasons we conclude that the trial court erred in granting summary judgment to the claimants. We further conclude that summary judgment should have been entered in favor of Maryland. The judgment is reversed, and judgment instead is entered that the claimants take nothing on their complaint against Maryland. Maryland is awarded its appellate costs.

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Stein, J.

We concur:

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Strankman, P.J.

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Marchiano, J.

Trial Court:	Superior Court Contra Costa County
Trial Judge:	HONORABLE BARBARA ZUNIGA
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